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The Paul Desmarais Chaired Professor of Partnership and Active Ownership
Director of “M&As and Corporate Strategy” Executive Education Programme

Build, Borrow or Buy
*When is M&A the right answer to your growth challenges?*
Outline

Research on M&A

What do we know so far?

The M&A puzzle

Why do good acquirers fail?

Build, Borrow, or Buy

Does it matter for survival?

Build, Borrow, or Buy in Practice

Where to start?
The shareholder value hit parade

**Average share price response**

- Leveraged buyouts: 40%
- Leveraged recapitalisations: 25%
- Share repurchase tender offers: 15%
- Exchange offers of debt for common stock: 14%
- Exchange offers of preferred for common stock: 8%
- Open market share repurchase: 4%
- Divestitures: 2%
- Private placements of equity: 1%
- Acquisitions (for acquiring firms): 0%
Acquirers’ poor returns persist over time

<table>
<thead>
<tr>
<th>Event window</th>
<th>Acquirer returns (across studies)</th>
<th># studies</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock market returns</td>
<td></td>
<td></td>
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<tr>
<td>&gt;180 days-3 years</td>
<td>-10%</td>
<td>103</td>
<td>25,205</td>
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<tr>
<td>&gt;3 years</td>
<td>-7%</td>
<td>26</td>
<td>5,966</td>
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<tr>
<td>Return on Assets</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>1-3 years</td>
<td>-2%</td>
<td>29</td>
<td>31,010</td>
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<tr>
<td>Return on Equity</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>1-3 years</td>
<td>-2%</td>
<td>14</td>
<td>1,790</td>
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<tr>
<td>Return on Sales</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-3 years</td>
<td>-3%</td>
<td>9</td>
<td>14,660</td>
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M&A damages capabilities – Notably at target

Whose assets are divested?

<table>
<thead>
<tr>
<th>Assets of the target</th>
<th>Assets of the acquirer</th>
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<tbody>
<tr>
<td>Administrative services</td>
<td>5%</td>
</tr>
<tr>
<td>Commercial networks</td>
<td>6%</td>
</tr>
<tr>
<td>Logistics assets</td>
<td>5%</td>
</tr>
<tr>
<td>Manufacturing assets</td>
<td>7%</td>
</tr>
<tr>
<td>R&amp;D assets</td>
<td>3%</td>
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</table>

% of firms responding that at least 30% of assets were divested post-acquisition
Sample size: 253 M&As; manufacturing industries; US & Europe

Source: Capron, L. Strategic Management Journal
M&A hurts employees’ motivation – Notably at target

Source: Kapoor & Kim. *Academy of Management Journal*, 318 inventors at 50 acquired software firms (U.S.)
Yet... M&A is a powerful tool for growth

Growth achieved through:

- **Portfolio momentum**
  Growth of the segments in its portfolio. 65%

- **M&A**
  Net revenue growth from M&As and divestments 30%

- **Share gain**
  Gaining or losing share from competitors 5%

Death rates 6x higher in low growth companies

First decade performance distribution; 1984-1994, 100 Largest US Companies

Looking beyond averages…

Source: Capron and Pistre, Strategic Management Journal 105 Horizontal M&As in manufacturing industries
The capability premium in M&A

Short-term performance
- Resource fit
  - Exploitation
  - Enhancement
  - Acquisition

Long-term performance
- Resource reployment
  - Tradeoff between preservation & integration
  - Resource divestiture
  - Complementary resource investments (CAPEX; R&D..)

Capron; 1999; Capron & Pistre, 2002; Capron & Arikan, 2014 Capron & Bertrand, 2014
We have plenty of textbooks on M&A execution

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<td>M&amp;A Lessons That Rise Above the Ashes</td>
<td>Robert F. Bruner (Foreword by Justin Isaacs, Jr.)</td>
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<td>The Complete M&amp;A Handbook</td>
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<td>Valuation for M&amp;A: Building Value in Private Companies, Second Edition</td>
<td>Chris M. Muller; Frank G. Evans</td>
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<td>Philippe C. Huyghebaert; David R. Jerison</td>
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<td>Patti Hanlon</td>
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<td>Scott C. Whitaker</td>
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<td>J. Robert Carlson; Claire S. Lindberg</td>
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We have “best practices” on M&A execution

- Portfolio fit & synergy
  - Johnson & Johnson
  - L'ORÉAL
  - Disney·PIXAR

- Price & deal structuring
  - DANONE
  - STONYFIELD

- Post-merger integration
  - DANAHER
  - CISCO

- Learning & replicability
  - CISCO
  - GE
The M&A puzzle:
Why do good acquirers stumble or fail?
Multiple mistakes in M&A but... the first is

M&A becomes “the strategy” – Instead of being a tool for strategy execution
Real issue: Failing to consider alternative growth options

- “The most serious mistakes are not being made as a result of wrong answers. The true dangerous thing is asking the wrong question” (Peter Drucker)
- … or, sometimes, not asking a question at all!

➢ Ask the right question: When is M&A the right path to grow?
When is M&A the right path to grow?

The «Better-Off» Test- What are our core capabilities? Where to leverage them given market opportunities?

The «Build-Borrow-Buy» Test- What is the best mode to exploit, enhance or acquire capabilities?

How to grow

Focus

Build
internal development

Borrow
licensing
alliances

Buy
M&A

Where to grow

Diversify

Increased complexity
Selecting a viable growth path: 
*The missing piece*

- **Strategic Resource Gap**
  - **Build**
  - **Borrow**
  - **Buy**

**Execution of Mode of Choice**

**Schering-Plough:**
1851-2009
From internal innovation to loss of independence

**“One-trick pony” & “opportunistic” firms eventually fail**

**Marconi** -ex GE-
1897-2006
From opportunistic deals in telco to financial distress
Selecting a viable growth path: Core thesis

Core thesis

Company survival is based on ability to select & balance modes of growth
Build, Borrow, Buy: Does it matter for survival?

**Surviving the digital revolution in global telecom (162 firms)**

- 40% of firms relied on one mode to grow (one trick-ponies).
- 33% used **all three modes** of growth.
- 27% used two out of three modes.

**Survival data**

- Firms using 3 modes of growth were more likely to survive
  - 46% vs. using only alliance
  - 26% vs. using only M&A’s
  - 12% vs. using only internal

**Prefer M&As to alliances** because they want exclusive access to the target’s capabilities

- 80% of firms

**Succeed in extracting the value from target’s capabilities**

- 27% of firms

BBB: Does it matter for survival of IPOed firms?

Surviving the IPO process
- 4,395 acquisitions (1988-2012)

# Delisted Firms after the IPO Year

- # Delisted by end of Year 5: 55% of IPOed firms
- # Delisted by end of 2012: 80% of IPOed firms

IPO & M&A activity
- 75% of IPOed firms had its first deal within the first 3 years
- Peak year of first acquisition deal: Year 1 following the IPO
- 21% of IPOed firms with no deals

- **Too many M&As, too fast**: Integration problems.
- **No M&A**: Growth problem.
Build, Borrow, Buy in practice

**Building BBB self-awareness**
- BBB Self-Assessment Test

**Learning to select the right mode of growth**
- Resource Pathway Framework

**Developing a BBB discipline within your organization**
- Management of BBB portfolio and learning
Building BBB self-awareness

**BBB Self-Assessment**

- Which growth mode do you use most?
- Who dominates the decision-making process?
- What is your corporate mantra?
Build – “We do it ourselves”

**BBB Self-Assessment**

- Internal development is mostly used.
- Internal R&D teams dominate the decision making process.
- Our corporate mantra – “We do it best”

**Inward-focused, slow, inert**
(RIM, Schering-Plough, Merck pre-2000)
Buy – “We buy our way in”

**BBB Self-Assessment**

- M&A is mostly used.
- M&A team dominates the capability-sourcing decisions
- Our corporate mantra: “Let’s get rid of expensive internal deadwood; let’s buy external resources”

**Fragmented, chaotic, bloated**
(Tyco, Cooper, Lyondell Chemical)
Borrow – “We need partners to help us”

**BBB Self-Assessment**
- Partnerships are dominant.
- Licensing and alliances teams dominate the capability-sourcing decisions.
- Our corporate mantra: “Open innovation in ecosystems of collaborators is the best way to move forward.”

**Partner-dependent**  
(Rover, Hero, Dacia)
Learning to select the right mode of growth

Resource Pathway Framework
(simplified version)

Strategic resource gap → BUILD? Internal resource relevance

- Low → Internal Development
- High → BORROW via contract? Resource tradability

BORROW via contract? Resource tradability

- Low → Contract/Licensing
- High → BORROW via alliance? Desired closeness with resource partner

BORROW via alliance? Desired closeness with resource partner

- Low → Alliance
- High → Acquisition

Revisit your build-borrow-buy options or redefine strategy

Source: Capron and Mitchell, 2012
Developing a BBB discipline within your organization

- It starts with the CEO and top management team
- Optimal BBB portfolio
  - Coordination of BBB teams
  - Pipeline of BBB opportunities
  - Selection tools, processes
  - Gain experience across BBB modes
  - Blending resources from different sources

BORROW
BUILD
BUY
Thank you!

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